

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B02  
PLR-115993-07

Date:  
July 27, 2007

### Legend

X =

Y =

A =

B =

n =

State1 =

State2 =

Date1 =

Date2 =

Date3 =

Dear :

This responds to a letter dated March 7, 2007, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting relief pursuant to § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State1 on Date1, and elected to be treated as an S corporation effective Date1. At the time of this election, the stock of X was held equally by two individuals, A and B. On Date2, B purchased all of the n shares held by A. Also on Date2, B sold n shares of X to Y, a limited liability company formed under the laws of State2 and classified as a partnership for federal tax purposes. At the time of transfer, Y was an ineligible S corporation shareholder, thereby terminating X's election as an S corporation on Date2. At the time of transfer, X and B did not realize that Y was an ineligible S corporation shareholder and that the transfer of X stock to Y would terminate X's S corporation election under § 1362(d)(2). Upon discovery of the terminating event, Y agreed to transfer all of the X stock that it held to its members in the same proportion as their ownership interests in Y. This transfer of stock from Y to its members was completed on Date3. X represents that all of the members of Y that received transfers of X stock from Y on Date3 are eligible S corporation shareholders.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consent, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were

inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely upon the information submitted and the representations made, we conclude that X's S corporation election terminated on Date2, when shares of stock of X were transferred to Y. We further conclude that the termination was an inadvertent termination within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation on Date2, and thereafter, provided that X's S corporation election was not otherwise terminated under § 1362(d) for other reasons.

All of X's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately stated items of income, loss, deduction or credit and nonseparately stated computed items of income or loss of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X to its shareholders as provided in § 1368. For this purpose, the members of Y shall be treated as if they directly purchased from B on Date2 the n shares of X that had been sold to Y on Date2, in the same proportion as each member's ownership interest in Y. X and its shareholders, including the members of Y during the termination period, shall make any adjustments as may be necessary, for federal tax purposes, consistent with this treatment. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed regarding whether X otherwise qualifies as a small business corporation under § 1361.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

J. Thomas Hines  
Branch Chief, Branch 2  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
Copy for § 6110 purposes